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When Life Insurance Becomes A Wager on Human Life

SB 151 strives to preserve the integrity of Life Insurance by prohibiting schemes that induce individuals -- typically seniors – to take out life insurance policies they would not otherwise purchase, so investors can acquire the policy and profit when the senior's life expectancy falls short of actuarial projections. Stranger Originated Life Insurance ("STOLI") threatens the undergirding of life insurance itself by shifting the balance of economic interest from the insured's survival to their untimely demise. The investors use the guise of "free insurance" and property rights to obscure the fact that they speculate in human life, precisely the conduct found both unconscionable and unconstitutional by the U.S. Supreme Court.

Background –

American public policy assures the integrity of life insurance by requiring that both the policy's initial owner and beneficiary have what is known as an "insurable interest." Specifically, Montana law in 33-15-201(3), MCA, defines insurable interest to include:

(1) individuals closely related by blood or by law with a substantial interest engendered by love and affection

(2) with a lawful and substantial economic interest in having the life, health or bodily safety of the individual insured continue as distinguished from an interest which would arise only by or would be enhanced in value by death or injury of the insured.

Montana's laws conform to Oliver Wendell Holmes' conclusion in *Grigsby v. Russell* that "a contract of insurance upon a life in which the insured has no interest is a pure wager that gives the insured a sinister counter interest in having the life come to an end." The public policy behind spreading the risk of death through life insurance to protect individuals and families from the financial devastation caused by untimely death remains so significant that despite fiscal pressures, Congress continues to offer favorable tax treatment to life insurance.

How STOLI Works –

1. An agent, fronting for an investor who cannot buy a policy directly on the insured because of a lack of "insurable interest," approaches a senior citizen.
2. The agent/investor offers the senior a financial inducement – typically free insurance and/or monetary compensation -- provided that they undergo a life expectancy examination and take out a policy with the expectation that it will be sold after the contestability period (the period in which an insurer can contest the policy for misrepresentation in the application) expires. A trust hides the investor's role.
3. The investor or a bank provides a non-recourse loan – the senior pays nothing and the policy is the only security for the loan – that will usually expire shortly after the two year contestability period.
4. At the end of the loan term, the senior can repay the loan or transfer the policy to the investor and the loan and interest are forgiven. As the premiums usually exceed several hundred thousand dollars and incur 14-27% interest, in reality the insured has little choice or incentive but to transfer the policy to the investor.
5. The investor, still lacking an insurable interest, now owns the policy and perversely will garner greater profits the sooner the insured senior dies.

Prepared by Jacqueline Lenmark, ACLI, January 27, 2009